

SECTION 2: CHINA'S APPROACH TO INTELLECTUAL PROPERTY RIGHTS AND ITS PRODUCTION OF COUNTERFEIT GOODS

The Commission shall investigate and report on—

“UNITED STATES–CHINA BILATERAL PROGRAMS—Science and technology programs, the degree of non-compliance by the People’s Republic of China with agreements between the United States and the People’s Republic of China on prison labor imports and intellectual property rights, and United States enforcement policies with respect to such agreements.”

“WORLD TRADE ORGANIZATION COMPLIANCE—The compliance of the People’s Republic of China with its accession agreement to the World Trade Organization.”

Key Findings

- Despite its many promises to comply with its international obligations to protect intellectual property, China has failed to deter widespread violations of trademarks, copyrights, and patents. The failure stems from lenient rules and regulations, mild penalties for transgressors, and an overall lack of enforcement. Although the central government has made some effort to pass stricter laws, enforcement at the local and provincial levels lags far behind. Ultimately, the central government is required by its World Trade Organization membership to accept responsibility.
- China’s failure to protect intellectual property is a serious problem for U.S. competitiveness. U.S. intellectual property industries contribute to more than half of all U.S. exports and represent 40 percent of U.S. economic growth. While the full extent of loss to U.S. industry due to Chinese intellectual property rights violations is unknown, U.S. industry reports losses totaling billions of dollars. The U.S. Chamber of Commerce estimates that the global intellectual property industry loses \$650 billion annually in sales due to counterfeit goods.³⁷ And some analysts estimate that China is responsible for as much as 70 percent of this counterfeit goods market.³⁸ Annual losses to the U.S. copyright industries are estimated to be between \$2.5 billion and \$3.8 billion.³⁹ And U.S. pharmaceutical industries lose 10 percent to 15 percent of annual revenues in China due to intellectual property infringement.⁴⁰
- The Customs Bureau of the U.S. Department of Homeland Security made 3,709 seizures of counterfeit goods originating from China in fiscal year 2005, totaling \$64 million.⁴¹ Total exports of counterfeit goods from China to the United States generally are estimated to be much higher and can be expected to increase even further. Not only is China’s enforcement of intellectual property laws weak, but China also has liberalized its strict ex-

port licensing regime to allow any business to export. As more businesses begin to export, counterfeit goods will be easier to ship.

- Counterfeit exports from China pose a health and safety threat to U.S. citizens. The World Health Organization reports that counterfeit pharmaceuticals of Chinese origin cost pharmaceutical companies \$32 billion a year.⁴² Chinese counterfeiters have produced batteries that explode because of faulty manufacturing, and engine timing belts that break after only one-fifth the time of the authentic product.⁴³
- Counterfeit products account for 15 percent to 20 percent of products made in China and equal eight percent⁴⁴ of China's \$2.2 trillion⁴⁵ gross domestic product (GDP). In some cities, the manufacturers and distributors of counterfeit goods are the major employers and the dominant contributors to the tax base.
- Many local governments in China are so financially dependent on the counterfeit trade that they are reluctant to interfere with the violations, and officials at those levels often profit personally from counterfeiting.
- Several U.S. industries, particularly those dependent on copyright protections, report high piracy rates of their products in China. For example, the piracy rate for business software has reached 86 percent.⁴⁶ In this situation, the WTO dispute settlement mechanism provides the strongest enforcement tool available to the United States government to address China's failure to enforce intellectual property rights.
- Market barriers to American exports to China contribute to the climate of piracy in China. When U.S. companies experience Chinese government censorship, delays, distribution restrictions, or other barriers in getting their products to market, counterfeiters move in first.

Overview

There is little disagreement among international bodies that China fails to enforce intellectual property rights (IPR). The requirement to enforce such international rules of commerce is a fundamental obligation of membership in the World Trade Organization (WTO), and for good reason: advanced economies especially depend on the innovation of inventors and visionaries. According to Christopher Israel, Coordinator for International Intellectual Property Enforcement at the Department of Commerce, American intellectual property industries contribute to more than half of all U.S. exports and represent 40 percent of U.S. economic growth. Fifty-five percent of U.S. companies operating in China were hurt by intellectual property rights violations, according to one survey.⁴⁷ Current estimates are that counterfeit and pirated products in China amount to eight percent of China's \$2.2 trillion GDP.⁴⁸ The U.S. Chamber of Commerce estimates that the global intellectual property (IP) industry loses \$650 billion in sales due to counterfeit goods.⁴⁹ Additionally, the Chamber estimates that 750,000 jobs every year are lost due to global counterfeits.⁵⁰ China is responsible for as much as 70 percent of this counterfeit goods market.⁵¹

The implications of China's failure to protect IPR can be divided into two aspects: 1) patent infringement serves to advance Chinese commercial interests as a form of government-coordinated industrial espionage that advances China's science and technology capacity; 2) and the failure to enforce intellectual property rights (patents, copyrights, and trademarks) and the existence of intellectual property-related trade barriers violate China's WTO obligations while they relieve pirates of the cost of complying with the rules.

In the case of the former, the Chinese government has deliberately formulated various strategies to "leapfrog" its science and technology development to keep pace with that found in developed countries. In the case of the latter, China has failed to meet its international obligations to protect intellectual property.

Despite repeated promises to do so during U.S.-China Joint Commission on Commerce and Trade meetings, and when it was being considered for accession to the WTO, China has not significantly reduced its copyright infringement rates. According to the U.S. recording industry, 85 percent of sound recordings sold in China in 2004 were pirated, or 17 of every 20 sold there.⁵² Across all copyright industries, piracy rates in 2005 remained between 85 and 93 percent.⁵³

IPR Violation as a Component of a Coordinated Science and Technology Strategy

Throughout the 1990s the Chinese government consistently developed science and technology plans based on assimilating foreign science and technology into Chinese society while "keeping the initiative in [China's] own hands."⁵⁴ As other developing nations have done, the Chinese government set out to appropriate foreign technology in order to "leapfrog" steps in the development of its national science and technology sector.

Central to China's science and technology development is the symbiotic relationship between military and civilian technology. China's National High Technology Research and Development Plan (the 863 Program)⁵⁵ was established in 1986 to focus on closing the science and technology gap between China and more technologically advanced nations. The program covers both civilian and military projects, emphasizes civilian projects, and prioritizes dual-use projects.⁵⁶ The goals of the 863 Program are to obtain technology and to encourage international participation in its projects.⁵⁷

The 863 Program continues today along with the National Program on Key Basic Research Projects (the 973 Program).⁵⁸ The 973 Program, in which the government plays a role similar to that of a venture capitalist, focuses on the growth of small and medium enterprises in China.

One element of the Chinese government's plan for science and technology development is encouraging patent infringement. The government fosters patent infringement in several ways. Chinese state certification requirements give access to foreign product designs to the Chinese Academy of Sciences and other government actors responsible for China's science and technology breakthroughs. On a variety of products, from industrial machinery to tele-

communications equipment to automotive parts, the Chinese government⁵⁹ requires a certification mark known as the China Compulsory Certification. “The certification mark serves as evidence that the ... product can be marketed, imported or used [in China].”⁶⁰ The certification requires that foreign companies provide product specifications, detailed information on applicable standards, and samples of their products for evaluation.⁶¹ The product specifications then are given to the very organizations that will use them to compete against the IP owner.

Chinese academic communities and enterprises facilitate patent theft through “competitive intelligence.”⁶² This constitutes the sort of industrial espionage once practiced by the Japanese in the 1980s and 1990s. China established formal “competitive intelligence” operations in 1995 when it established the Society for Competitive Intelligence in China. By using this term common in Western industry, China attempted to make its activities sound like “business as usual.” With membership including the Chinese Academy of Sciences and representatives from state-owned enterprises and the academic community, it is currently chaired by a representative of the Chinese company NORINCO.⁶³ But as of the early 21st century, the operations are still considered to be in the nascent stage by Chinese scholars. In 2001, a Chief Specialist in the 973 Program and a professor at Qinghua University, Luo Jianbin, wrote in China’s Science and Technology Daily (*Keji Ribao*) that Chinese companies needed to increase the level of “competitive intelligence” operations on par with those of the Japanese in the early 1990s in order to “leapfrog” China’s science and technology development.⁶⁴

Both central and local government entities encourage such industrial espionage. A research website sponsored by China’s Ministry of Science and Technology states the importance of a national competitive intelligence model. The author points to Japanese competitive intelligence as a successful system where the central government leads the competitive intelligence activities of the nation.⁶⁵ Furthermore, a competitive intelligence system could and should be used to safeguard national defense and public security,⁶⁶ placing competitive intelligence strategy in line with the Chinese government’s broader science and technology goals.

The Chinese Academy of Sciences sees patents as key to China’s “leapfrog” endeavor in science and technology development: “High technology can be mastered more quickly through the use of patent information ... While making use of patents, enterprises can also put inventions and technological innovations under patent protection.”⁶⁷ The website of China’s State Intellectual Property Office demonstrates China’s approach to competitive intelligence. The article illustrates that a firm can gain a competitive edge both by patenting its new IP before competitors patent similar products, and by reverse engineering⁶⁸ similar items produced by competitors.⁶⁹

The Chinese Government’s Lack of Enforcement

Some specific local economies in China rely on the profits derived from the sale of counterfeit goods.⁷⁰ Consumers there are freely able to purchase pirated goods through wholesale and retail markets

and need not use any underground economy or black market. In some cases, administrative and law enforcement officials at the local level are directly or indirectly involved in counterfeit goods production and distribution. When the violator is a major employer or taxpayer, local officials refuse to enforce the law to avoid jeopardizing a large source of revenue. The town or city may depend almost entirely on the illegal enterprise to generate funds for education or health care.

In addition, organized crime, particularly in southern China, is involved in the manufacture and distribution of pirated goods. Criminals help extend local counterfeit markets to the international level using direct exports or through connections to organized crime networks in Hong Kong and Taiwan.⁷¹

The Case of Yiwu

Yiwu, located in the center of Zhejiang province just south of Shanghai, has a population of about 1.6 million and, in 2004, its GDP was \$3.6 million.⁷² Yiwu is known throughout China and the world for its large commodities markets. However, in Yiwu the wholesale market thrives on counterfeit goods. It was established through local government investment and is now the largest taxpayer in Yiwu. Since the same local government that established the market is also responsible for enforcing laws and regulations against counterfeiting, it is no wonder that local enforcement is nil.⁷³ The U.S. Trade Representative's Special 301 Report of 2006 pinpoints the province of Zhejiang as one of China's four "hot spots" where there is a severe lack of IPR enforcement.⁷⁴ Indeed, Yiwu has become a byword for "fake" in China.

The Yiwu Wholesale Market serves as one of China's largest wholesale centers, and an important distribution center for small commercial goods. Some 410,000 different items reportedly are sold in the market, including fake Gillette razor blades with wholesale prices as low as 65 cents for 10 boxes as opposed to the \$9.60 someone in Beijing would pay for a real 10-pack.⁷⁵ Two hundred thousand distributors purchase 2,000 tons of goods every day and transport these products to all regions of China and throughout Asia, Africa, and South America. According to Yiwu officials, \$2.4 billion worth of goods were sold in 1997, the last year for which figures were made publicly available—more than the total business of most multi-national enterprises in China.⁷⁶

While most Chinese local governments do not appear to have the will to enforce IPR, the central government's resolve to address the issue is not much stronger. While some in the central government take intellectual property rights seriously, others see piracy as a typical path for developing nations attempting to foster economic development. For example, if members of the central government strive to develop a globally competitive company in China and believe foreign technology might facilitate that goal, the government may allow the company to obtain the technology illegally.⁷⁷ Various economic justifications are advanced to explain the lack of enforce-

ment. Should the central government initiate a national crackdown on IP infringement, cities like Yiwu would be devastated, with tens of millions unemployed, say advocates of non-enforcement. Either the central government would have to tackle and ameliorate severe economic and social consequences, or it would have to face the impacts of those severe consequences.⁷⁸

The difficulties presented by intellectual property theft in China came into sharp focus during the June 2006 Commission fact-finding trip to China. Contradictions were evident among Chinese authorities over the extent and seriousness of the problem. At the Ministry of Commerce, Deputy Director General Jin Xu insisted that IPR violations in China were “negligible” and that those Americans who thought otherwise were merely being duped by inaccurate news accounts. He insisted that no one in China “knowingly” uses pirated software, for example, because it is likely unreliable. This assertion is in contrast to estimates from some American software companies that 90 percent of the computer software in use on Chinese computers is unlicensed.

Yet, the following day, top officials of the State Intellectual Property Office acknowledged that IPR theft is prevalent and pledged China’s cooperation in addressing the problem. China, they pointed out, had only begun to protect intellectual property in the 1980s and still has a considerable way to go to approach the degree of protection in the United States and Europe.

At a dinner with a dozen U.S. businessmen and -women hosted by the U.S. Consul General in Shanghai, one executive estimated that 40 percent of Chinese exports of manufactured goods were counterfeit. No one disputed this remarkably high figure, and when a private investigator remarked with a smile that his anti-piracy business was “very lucrative,” the others merely laughed ruefully. While those present agreed that there had been a flurry of anti-piracy edicts from the central government, they also noted that actual enforcement at the local level is practically non-existent. Citing the case of an American consumer products company fighting a losing battle against Chinese counterfeiting, one American explained the reluctance of municipal officials to act by saying, “One local firm was making the labels, one the bottles, and one the shampoo . . . shut it all down and you’d have social unrest.” In addition, some U.S.-based businesses with strong brands to protect fear an adverse consumer reaction if the consumers are told they may be buying counterfeit goods. “Certain companies are not happy being portrayed in the press as victims of counterfeiting,” said one American CEO.

At one point during their trip to China, the Commissioners visited a shopping mall, the “International Commodity Plaza” near the Port of Shanghai. Inside were dozens of shops selling designer shirts, suits, shoes, handbags, watches, jewelry, electronics, and other goods. Their extremely low prices, misspelled labels, odd packaging, and nervous shopkeepers marked the goods as clearly counterfeit. Such shopping markets openly display their wares in each of the Chinese cities the Commission has visited, often within the full view of law enforcement authorities.

In theory, a developing nation might improve IPR protection within its borders to attract foreign direct investment, and particu-

larly to attract high-value-added industries. But in China's case, the level of foreign direct investment remains high despite the lack of improvement in IPR protection. However, the level of foreign investment in basic research projects remains low compared to the high investment in applied research, as foreign companies protect their key IP from exposure to China's pirates. The "innovation society" China is promoting during implementation of its eleventh Five-Year Plan could lead to increased levels of higher-end IP and thus require an increase in patent protection. But while the central government may have some incentive to improve patent protection in order to protect future Chinese innovations, there is no such incentive to safeguard already-copyrighted material.⁷⁹

Legislation and Enforcement

China does not currently make use of effective measures for enforcing its IPR laws and regulations.⁸⁰ Without the vigorous use of effective enforcement tools, any efforts to crackdown on IPR infringement are doomed. According to the USTR, "China's own 2004 data showed that it channeled more than 99 percent of copyright and trademark cases into its administrative systems and turned less than one percent of cases over to the police. The trademark and copyright industries continue to point out that administrative fines are too low to provide a deterrent, and as a result, pirates consider administrative seizures and fines to be merely the cost of doing business."⁸¹

China already has incorporated in its IPR law Articles 9 to 14 of the WTO's Trade-Related Aspects of Intellectual Property Rights (TRIPS) Agreement.⁸² However, the legislation it uses to fulfill its obligations is inadequate. For example, during the 2005 meeting in Washington DC of the U.S.-China Joint Commission on Commerce and Trade, (JCCT), China agreed to enact legislation fulfilling World Intellectual Property Organization (WIPO) Internet treaty obligations. But when the U.S. Trade Representative's office examined the implementing legislation, it found that the legislation fails to provide legal protection and remedies against copyright infringement.

Currently, there are three types of IPR enforcement mechanisms in China, each with its own deficiencies:

- **Administrative Enforcement**, which occurs at the local level, is characterized by dilatory implementation and inadequate penalties. In 2004, there were 51,851 administrative cases of trademark infringement and counterfeiting, only 5,494 of which involved foreign rights holders. The average fine was \$620 per case and only 96 cases were referred for criminal prosecution. That same year there were 9,691 copyright infringement cases, 158 involving a foreign right holder, of which only 102 cases were referred for criminal prosecution.⁸³ It should be noted that because the Chinese administrative enforcement system is opaque, it is not possible to determine the outcome of these cases and evaluate how the system is working in practical terms.
- **Civil Enforcement** provides a specialized, IPR-trained judiciary and nationwide jurisdiction. However, China does not have an independent judiciary. Further, damages awarded by Chinese

courts are difficult for plaintiffs to collect. From January to November 2005, there were 11,468 IP-related civil cases (5,240 copyright, 2,491 patent, and 1,482 trademark cases), about five percent of which involved foreign rights holders.⁸⁴

- **Criminal Enforcement** provides a stronger means of deterring piracy, such as the ability to imprison offenders. A 2004 judicial interpretation lowered the thresholds for criminal cases and included new provisions addressing online copyright piracy, accomplice liability, and the import and export of infringing goods. However, Pei Xianding, senior judge at China's Supreme People's Court, told the Commission delegation in June that further lowering the threshold for criminal prosecution in IPR cases will require an amendment to the relevant law by the National People's Congress. Additionally, questions remain unanswered about how to assign value to seized goods, and prosecutors must prove the piracy activity generated a profit and the merchant knew the goods were counterfeit. Judicial interpretation eliminated a "three strikes" rule that required criminal prosecution for third-time repeat offenders.⁸⁵ The pace of prosecution is glacial: China's Public Security Bureau initiated 2,991 IP criminal cases in 2005, with 261 cases concluded and the remaining 2,661 still progressing.⁸⁶ While information on the consequences of criminal cases is difficult to obtain and what can be obtained often is difficult to evaluate, U.S.-based copyright industry representatives reported that 52 investigations resulted in 31 indictments. Eighteen of these cases resulted in criminal fines. Twenty-one resulted in jail time; 12 prison terms were suspended; 42 were not suspended.⁸⁷

Export of Counterfeits

The Customs Bureau of the U.S. Department of Homeland Security conducted 3,709 seizures of counterfeit goods, valued at \$64 million, originating from China in fiscal year 2005.⁸⁸ Products of Chinese origin account for 69 percent of total product seizures at the U.S. border or more than ten times the product seizures of imports from any other trading partner.⁸⁹ Still, such seizures at U.S. ports are only a fraction of the actual imports of counterfeit goods. This is partly attributable to the fact that the Department of Homeland Security (DHS) has not placed the seizure of counterfeit goods among its top enforcement priorities. Even so, the value of goods seized by DHS's Immigration and Customs Enforcement (ICE) unit as of April 2006 already had surpassed the total value seized in FY2005, \$93 million.⁹⁰ The great majority of those items seized were exported by China.

The Commission expects that exports of counterfeit products from China will continue to increase. China previously granted export and import rights only to state-owned trading companies. However, due to its WTO obligations, in July 2004, China amended the law so that any business operator could register to export, eliminating the extra step of using a state-owned company as a middle man, which both legitimate exporters and counterfeiters had to take in order to distribute internationally.⁹¹ This reduces

government control and makes it easier for counterfeiters to export their products.

Health and Safety Concerns

China became the world's largest supplier of counterfeit drugs in 2004.⁹² The World Health Organization reports that counterfeit pharmaceuticals of Chinese origin cost pharmaceutical companies \$32 billion a year.⁹³ U.S.- and Europe-based multinational companies investigated 400 interlinked websites marketing and selling counterfeit pharmaceuticals, both lifestyle and non-lifestyle drugs, all manufactured in China.⁹⁴ Some major pharmaceutical companies are finding so much counterfeit product that they are expanding their testing facilities.⁹⁵ Counterfeit pharmaceuticals pose a serious threat because they may vary in content from the legitimate product—or bear no chemical resemblance to it; indeed, they may be composed of toxic materials. Moreover, it is difficult for consumers to determine if the product is counterfeit or not, as the packaging of counterfeit drugs is often identical to the original and consumers may be unaware of the danger.⁹⁶

Counterfeit alcohol, tobacco, and pharmaceuticals appear to have the highest potential for human injury. However, other counterfeit products also cause safety concerns; Chinese counterfeiters have produced batteries that explode because of faulty manufacturing and engine timing belts that break after only one-fifth the time of the authentic product.⁹⁷

U.S. Industry

U.S. companies' investments in China often provide Chinese access to the technologies of U.S. patent holders. Sometimes technology acquired in this way is diverted to China's illegitimate economy.⁹⁸ However, foreign direct investment or any other U.S. industry presence is not required for Chinese IP infringement.

The U.S. Patent and Trademark Office advises that all U.S. businesses that plan to have an Internet presence, international trade show, or other similar exposure, regardless of whether they plan to manufacture or market in China or engage a Chinese entity, should plan carefully to protect their IP from the threat of Chinese piracy.⁹⁹

Market access barriers prevent U.S. companies from entering and serving the Chinese market efficiently. This provides an opportunity for pirates to operate in the market before or in place of U.S. companies.¹⁰⁰ Market access restrictions, such as delays in regulatory approval and restrictions on distribution rights, “artificially limit the availability of foreign content and thus lead consumers to the black market.”¹⁰¹ U.S. movie makers, whose showings are limited to a handful of films allowed into Chinese theaters, are a frequent target of counterfeiters since consumers cannot see the movies on the big screen. Furthermore, industries not permitted to operate independently in China face additional vulnerabilities.

Former Congresswoman Pat Schroeder, current president and CEO of the Association of American Publishers, testified to the Commission that U.S. book publishers conservatively estimate that they lost \$52 million in sales in China due to IP theft in 2005.¹⁰² Foreign publishers are not permitted to operate independently in China and each must partner with a local publisher, some of whom are not interested in protecting foreign copyrights and may, in fact, steal the foreign publisher's copyrighted materials. Furthermore, foreign books are often translated into Chinese and sold without permission. College textbook piracy is rampant at Chinese universities; in fact, universities often photocopy textbooks to sell to the students. Schroeder stated that U.S. publishers could compete with Chinese publishers at a fair price if they were permitted to publish independently in China. However, because of the local partner requirements, U.S. publishers must rely on their Chinese partners to import books, and the cost is far higher.

Chinese enforcement against piracy often consists of merely destroying end products such as pirated DVDs or books, but not removing, confiscating, or destroying the production equipment. The result is that pirates often resume production rapidly after seizure of their current inventory.

Some multinational corporations tolerate a certain level of IP infringement to operate in China, often without publicly complaining for fear of being shut out of the China market.¹⁰³ For example, one multinational corporation has thanked the Chinese government for its improvements in IP protection, while at the same time the company's managers in China are grappling with a multi-billion-dollar-a-year loss due to Chinese infringement. Nevertheless, multinational corporations continue to invest in research and development facilities located in China. At the same time, some of these companies that operate in the United States do not provide sufficient data to the U.S. government to enable it to work on behalf of their IP interests in world bodies such as the WTO.

This type of corporate behavior allows the Chinese government to hide behind cosmetic changes to its IPR protection laws and enforcement procedures while undertaking no significant changes.¹⁰⁴ During their fact-finding trip to China in June, the Commission witnessed the consequences of such behavior to some multinational corporations. To battle the growing wave of counterfeiting, one U.S.-based consumer products company was forced to hire private investigators to bring cases to court, only to find that the fines levied on violators were hardly more than an annoyance for counterfeiters who were back in business the next day.

For small and medium-sized enterprises, intellectual property theft can be devastating. This sector is critical to America's innovation-rich economy. Pat Choate of the Manufacturing Policy Project recounted to the Commission his estimate that 45 percent of all U.S. inventions are the products of small and medium-sized enterprises, individual inventors, universities, or research institutions.¹⁰⁵ "Increasingly, counterfeiters are targeting American small and medium-sized enterprises and thereby seriously undermining their ability to compete in global markets."¹⁰⁶

At present, there are no established means whereby U.S. importers can be confident that they are not importing counterfeit goods

from China and therefore may be incurring liability. According to Dr. Choate's testimony, placing liability on the importer of record could decrease the likelihood that counterfeit goods can enter and be sold in the United States.¹⁰⁷ He told the Commission that such a measure would serve three important purposes: it would combat piracy by reducing its profitability; it would increase protection for Americans from catastrophic failures of sensitive counterfeit goods such as auto and aircraft parts and pharmaceutical products, and from the economic costs of other counterfeit failures; and it would substantially reduce the potential of costly liability claims against American firms when their products have been counterfeited and subsequently have failed to meet legal or warranty obligations.

U.S. Government Efforts

The lack of intellectual property protection has been a frequent topic of conversation during meetings of the U.S.-China Joint Commission on Commerce and Trade. Chinese authorities have given U.S. officials repeated assurances that they are strengthening laws, regulations, and penalties pertaining to intellectual piracy. But Chinese officials have not been able to point to any decrease in violations or even an increase in the penalties assessed on violators.

The most recent meeting of the Joint Commission in April 2006 secured China's most specific promise to date on protection for business software. The Chinese government pledged that future regulations would require computer manufacturers to pre-load computers with authentic operating system software. Government ministries would be required to purchase only computers that were pre-loaded with legal operating systems. Until now, most Chinese computers sold domestically had not been preloaded with software operating systems. This encouraged consumers to shop for the lowest-cost operating systems, which invariably are pirated. But by late September 2006, the International Intellectual Property Alliance reported that it had no evidence that the change had been implemented and could find no increase in software sales that could be expected to come from stricter enforcement.¹⁰⁸

**IPR Protection Agreements China Signed with the
United States or with the United States and Other
Nations**

1979

Agreement on Trade Relations Between the United States and China—includes pledge to protect U.S. patents, trademarks, copyrights, and industrial property in China

1980

China's Accession to the World Intellectual Property Organization

1985

China's Accession to the Paris Convention for the Protection of Industrial Property

1989

U.S.-China Memorandum of Understanding on Enactment and Scope of PRC Copyright Law

1992

U.S.-China Memorandum of Understanding on Intellectual Property Rights. China's Accession to the Berne Convention for the Protection of Literary and Artistic Works

1993

Convention for the Protection of Producers of Phonograms Against Unauthorized Duplication of their Phonograms

1995

U.S.-China Memorandum of Understanding on Intellectual Property Rights

1996

U.S.-China Memorandum of Understanding on Intellectual Property Rights

2001

China's Accession to the WTO—Agreement on Trade Related Aspects of Intellectual Property Rights

The U.S. Trade Representative, recognizing that much of China's intellectual property protection problem is concentrated in specific areas and that enforcement primarily occurs at the local level, is promising a review of Chinese IPR protection efforts at the provincial level this year. In addition, it is reportedly readying an IPR infringement case against China through the WTO.

*"Faced with only limited progress by China in addressing certain deficiencies in IPR protection and enforcement, the United States will step up consideration of its WTO dispute settlement options. In addition, the United States will conduct a special provincial review in the coming year to examine the adequacy and effectiveness of IPR protection and enforcement at the provincial level. The goal of this review will be to spotlight strengths, weaknesses, and inconsistencies in and among specific jurisdictions, and to inform next year's Special 301 review of China as a whole."*¹⁰⁹

The U.S. Trade Representative also is expanding the staff dealing with IPR issues at the U.S. Embassy in Beijing. At its Washington headquarters, the Representative has created a China Enforcement Task Force.¹¹⁰ The U.S. Patent and Trademark Office stationed an IP attaché in the U.S. Embassy in Beijing and is due to add two additional IP attorneys this year.¹¹¹

The U.S. Government is expanding the tools it offers industry to protect its IP. It permits businesses to record trademarks directly with Customs and Border Protection agents. It is educating small and medium-sized enterprises on how to protect their intellectual property. In 2004, the U.S. Trade Representative and the Departments of Commerce, Justice, State, and Homeland Security established the Strategy Targeting Organized Piracy (STOP) Initiative. STOP provides a visible, accessible point in the Federal Government where businesses can report cases of intellectual property infringement through either the stopfakes.gov website or the STOP! hotline. Since its inception, the stopfakes.gov website has received 1.8 million visits, and in the first quarter of fiscal year 2006 the STOP! hotline received 550 calls.

WTO Dispute Mechanism and Other International Trade Remedies

The WTO dispute settlement mechanism should be a key tool to protect the IPR of U.S. businesses in an era of globalization. But the United States has seldom used this tool to address cases involving China even though, in one of the non-IPR-related cases where it was employed, the process led to a satisfactory conclusion: swift negotiations to end a discriminatory practice by China.

The reluctance of the USTR to use the WTO process to adjudicate disputes about whether China is violating its WTO obligations is partially attributable to weaknesses in the quasi-judicial WTO dispute settlement system itself. But there are other reasons. Some delay is due to the historical preference in the Office of the U.S. Trade Representative for entering into negotiations with the governments of offending nations even before filing a WTO case. Even more important is the Representative's emphasis on building the strongest possible case and enlisting other countries as plaintiffs. This effort has been complicated by the reluctance of U.S.-based businesses with operations in China to provide to the U.S. government necessary evidence of intellectual property infringement in China because of fears that Beijing will withdraw favors and investment incentives from any company bold enough to speak out.

The U.S. Trade Representative currently is developing a WTO complaint based on China's failure to enforce international rules against piracy. In order to minimize the risk of retaliation against individual companies by Chinese authorities, the Representative is working through several industry associations and hopes to collaborate on that case with counterparts from the European Union, Japan, and other trading partners.¹¹²

Although IPR enforcement may be primarily the province of local or regional officials in China, under WTO rules the central government bears ultimate responsibility for all trade-related matters

and, in particular, for the actions (or inactions) of any level of government.¹¹³ The most likely successful WTO case for the United States would be based on Trade Related Aspects of Intellectual Property Rights (TRIPS) Articles 41 and 61, which provide that TRIPS members shall ensure they have effective enforcement procedures against IP infringement.¹¹⁴ China clearly does not.

In addition to the WTO dispute settlement mechanism, the United States has used other WTO tools to place multilateral pressure on China. Last year, the United States, Japan, and Switzerland made simultaneous requests to China under the TRIPS Agreement to provide information on judicial decisions and administrative rulings related to IP theft.¹¹⁵ China has failed to provide this information.